

Date 6-2-94

Surname [REDACTED]

[REDACTED]

Employer Identification Number: [REDACTED]

Key District: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax as an organization described in section 501(c)(4) of the Internal Revenue Code. We have determined that you do not qualify for exemption under that section of the Code. Our reasons for this conclusion and the facts upon which it is based are explained below.

The information submitted indicates that you were created by [REDACTED] State statute effective [REDACTED]. Your stated purposes are to assure stability in the property insurance market for property located in the State, to assure the availability of basic property insurance as defined by the statute, and to provide for the equitable distribution among member insurers of the responsibility for insuring qualified property for which basic property insurance cannot be obtained through the authorized insurers. The statute provides that all insurers authorized to transact property or casualty insurance in the State, and not engaged only in writing motor vehicle insurance, shall be and will remain your members as a condition of their authority to transact the business of insurance in the State. Each member insurer shall participate in your writings, expenses, profits, and losses in the proportion that your net direct written premiums during the preceding calendar year bear to the net direct written premiums for all member insurers for the preceding calendar year. The statute also provides that you may add additional insurance coverages with the approval of the [REDACTED] Insurance Commissioner, including coverage for commercial risks up to the limits of coverage for residential risks as set forth in your plan of operation. Further, the statute provides that all financial institutions shall consider a policy issued by you to be the same as a similar policy issued by an insurer authorized to transact insurance in [REDACTED].

[REDACTED]

Your plan of operation, which serves as your bylaws, states that your board of directors shall consist of [REDACTED] members, [REDACTED] voting members selected by member insurers (subject to the approval of the commissioner), [REDACTED] non-voting member appointed by the commissioner to represent insurance agents, and [REDACTED] non-voting members appointed by the commissioner to represent the public. Your plan of operation states that you shall operate two insurance coverage programs: Program One shall provide coverage under the standard fire policy and extended coverage endorsement in those [REDACTED] areas on [REDACTED] specifically designated as such by order of the commissioner; Program Two shall provide homeowner's and other dwelling coverage for [REDACTED] risks in areas designated by the commissioner other than those covered under Program One.

As required by statute, your plan of operation includes a requirement to establish the rates to be charged for the insurance coverages, so that the total premium from all association policies, when combined with the investment income, shall annually fund your administration. Your administration shall include the expenses incurred in processing applications, conducting inspections, issuing and servicing policies, paying commissions, and paying claims.

In your application, you state that the State's purpose for enacting this bill is to provide property insurance coverage for owners who are unable to obtain property and casualty insurance from private insurance companies due to perceived risk. You also state that you anticipate that you will be financially self supporting and that your sole source of revenue will be from insurance premiums that are sold to the public.

Section 501(c)(4) of the Code provides for the exemption from federal income tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(2)(i) of the Income Tax Regulations provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.

Section 1.501(c)(4)-1(a)(2)(ii) of the regulations provides that an organization is not operated primarily for the promotion of social welfare if its primary activity is carrying on a

business with the general public in a manner similar to organizations which are operated for profit.

Section 501(m)(1) of the Code provides, in part, that an organization described in 501(c)(4) shall be exempt from tax only if no substantial part of its activities consists of providing commercial-type insurance.

Section 501(m)(3) of the Code provides that the term "commercial-type insurance" shall not include:

(A) insurance provided at substantially below cost to a class of charitable recipients,

(B) incidental health insurance provided by a health maintenance organization of a kind customarily provided by such organizations,

(C) property or casualty insurance provided (directly or through an organization described in section 414(e)(3)(B)(ii) by a church or convention or association of churches for such church or convention or association of churches,

(D) providing retirement or welfare benefits (or both) by a church or a convention or association of churches (directly or through an organization described in section 414(e)(3)(A) or 414(e)(3)(B)(ii)) for the employees (including employees described in section 414(e)(3)(B)) of such church or convention or association of churches or the beneficiaries of such employees, and

(E) charitable gift annuities.

Rev. Rul. 68-46, 1968-1 C.B. 260, holds that an organization does not qualify for exemption from federal income tax under section 501(c)(4) of the Code where it is primarily engaged in renting a commercial building and operating a public banquet and meeting hall having bar and dining facilities. Although the organization carried on various social welfare activities, the revenue ruling determined that the organization's business activities exceeded all its other activities and thus the organization is not exempt under section 501(c)(4).

Rev. Rul. 69-385, 1969-2 C.B. 123, holds that a community welfare corporation that purchases and sells unimproved land and engages in other business activities, the profits from which are distributed to members, is not exempt under section 501(c)(4) of

the Code. The revenue ruling concludes that the organization is authorized to make, and in fact made, distributions of profits to its members. These distributions are equivalent to dividends based upon equity ownership and result in profit to the members. It is held that the organization does not qualify for exemption under section 501(c)(4) since the authority for making the distributions and the distributions themselves are incompatible with the requirements of the regulations that an organization must not be organized or operated for profit.

Allied Fidelity Corp. v. Commissioner, 572 Fed. 2d 1190, 1193 (7th Cir. 1978) citing 1 Couch on Insurance 2d 1:2 (1959), states that the common definition for insurance is an agreement to protect the insured against a direct or indirect economic loss arising from a defined contingency whereby the insurer undertakes no present duty of performance but stands ready to assure the financial burden of any covered loss.

The information you have submitted establishes that your sole activity is the provision of basic property insurance, and that your member insurers share the profits and/or losses from your operation. To effectuate this purpose, you will insure that persons contracting with you will be relieved of the financial burdens which could befall them if a covered incident did occur. These persons pay their premiums to you and you will assume the risk of liability. This is the definition of insurance (see Allied Fidelity Corp., supra). As stated in section 1.501(c)(4)-1(a)(2)(ii) of the regulations, and as illustrated in Rev. Rul. 68-46, supra, if an organization is operated primarily for the purpose of carrying on a business with the general public in a manner similar to organizations operated for profit, it is not described in section 501(c)(4) of the Code. Further, your members will share in your possible profits, even if such a possibility is considered unlikely, which provision is the equivalent to dividends based on equity ownership which is incompatible with section 501(c)(4) as illustrated in Rev. Rul. 69-385, supra.

Section 501(m) of the Code does not define the term "commercial-type insurance." Rather, it specifically states in section 501(m)(3) that five types of insurance are excluded from the definition of "commercial-type insurance." None of the excluded types of insurance describe the kind of insurance you provide inasmuch as (A) your insurance is not provided below cost or to a class of charitable recipients, (B) you are not a health maintenance organization providing incidental health insurance, (C) you are not a church or convention or association of churches providing property or casualty insurance, or (D) providing retirement or welfare benefits, and (E) you are not offering

[REDACTED]

charitable gift annuities. Therefore, we have concluded that you provide commercial-type insurance within the meaning of section 501(m) as your sole activity, which two facts preclude exemption under section 501(c)(4) as provided in section 501(m)(1).

For these reasons, we conclude that you do not qualify for recognition of exemption from federal income tax under section 501(c)(4) of the Code. You are required to file federal income tax returns.

You have the right to protest this ruling if you believe that it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 30 days of the date of this letter and must be signed by one of your officers. You also have a right to a conference in this office after your protest statement is submitted. If you want a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your officers, he/she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If we do not hear from you within 30 days, this ruling will become final and copies of it will be forwarded to your key District Director. Thereafter, any questions about your federal income tax status should be addressed to your key District Director.

When sending additional letters with respect to this case to the Internal Revenue Service, you will expedite their receipt by placing the following symbols on the envelope: [REDACTED]. These symbols do not refer to your case but rather to its location.

Sincerely yours,

[REDACTED]

[REDACTED]  
Chief, Exempt Organizations  
Rulings Branch 4

cc: [REDACTED]

	Initiator	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer
Case	[REDACTED]	[REDACTED]					
Signature	[REDACTED]	[REDACTED]					
Date	3-21-94	4-15-94					